

KELLEY DRYE & WARREN LLP

A LIMITED LIABILITY PARTNERSHIP

1200 19TH STREET, N.W.

SUITE 500

WASHINGTON, D.C. 20036

(202) 955-9600

FACSIMILE

(202) 955-9792

www.kelleydrye.com

DIRECT LINE 202-.955.9890

E-MAIL: sjoyce@kelleydrye.com

NEW YORK, NY

TYSONS CORNER, VA

LOS ANGELES, CA

CHICAGO, IL

STAMFORD, CT

PARSIPPANY, NJ

BRUSSELS, BELGIUM

HONG KONG

AFFILIATE OFFICES

BANGKOK, THAILAND

JAKARTA, INDONESIA

MANILA, THE PHILIPPINES

MUMBAI, INDIA

TOKYO, JAPAN

June 24, 2002

VIA ELECTRONIC FILING

Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, S.W.
Washington, D.C. 20554

Re: Reply Comments, CC Docket No. 96-128, *Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*

Dear Ms. Dortch:

Attached please find the Reply Comments of T-NETIX, Inc. ("T-NETIX") filed electronically in the above-captioned case.

Please do not hesitate to contact me with any questions or concerns regarding this matter: 202.955.9890.

Sincerely,



Stephanie A. Joyce
Counsel for T-NETIX, Inc.

Attachment

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20054**

In the Matter of)	
)	
Implementation of the Pay Telephone)	CC Docket No. 96-128
Reclassification and Compensation Provisions)	
Of the Telecommunications Act of 1996)	

REPLY COMMENTS OF T-NETIX, INC.

Glenn B. Manishin
Stephanie A. Joyce
Kelley Drye & Warren LLP
1200 19th Street, N.W., Suite 500
Washington, D.C. 20554
202.955.9600
202.955.9792 fax

Dated: June 24, 2002

TABLE OF CONTENTS

SUMMARY	ii
I. THE COMMISSION SHOULD EXERCISE ITS PLENARY SECTION 276 JURISDICTION TO ALLEVIATE THE UPWARD PRESSURE ON INMATE PHONE RATES CAUSED BY SITE COMMISSIONS	1
II. THE COMMISSION SHOULD NOT REVISIT ITS DECISION TO REJECT A FEDERAL PER-MINUTE MINIMUM RATE	6
III. THE COMMISSION SHOULD NOT SET OR REQUIRE RATE CAPS THAT DO NOT PERMIT THE RECOVERY OF SITE COMMISSION COSTS	10
IV. THE RECORD DOES NOT SUPPORT THE ADOPTION OF DEBIT CARDS FOR INMATE TELEPHONE SERVICES	12
CONCLUSION	13
Appendix A: Further Declaration of Richard Cabe, Ph.D. (June 21, 2002)	
Appendix B: T-NETIX Site Commission Survey	

SUMMARY

The record in this case shows that site commissions remain the most important component of inmate telecommunications service rates, and thus are the best focus for any Commission action designed to reduce competitive market pressures that increase inmate rates. No other proposal of the Commission — either debit cards or rate caps — received unanimous support from the commenting parties, yet every commenter acknowledged that site commissions are a key component of inmate rates.

Due concern for the prerogatives of state agencies should not deter the Commission from invoking its plenary jurisdiction over payphones to address site commissions. Although state correctional authorities are empowered to administer their prison and jail facilities in the manner they choose, where their inclusion of ever-increasing site commissions affects the rates, terms or conditions of the nation's telecommunications, Commission action is justified. Further, state commissions have been largely unable to deal with this issue, rendering federal action necessary. Admonitions to the contrary are more an attempt to preserve the *status quo* than to protect state sovereignty.

If the Commission relies on Section 276 to address site commissions directly, rate caps will be virtually unnecessary. Rate caps simply set a ceiling for rates, but do not place any downward pressure on rates. Nor are they easily calibrated to deal with market changes — they often are by far the *highest* rates in any given state.

Should the Commission nonetheless impose rate caps in this market, or instruct state commissions to do so, it must be sensitive to the impact of site commissions on carriers. They are plainly a cost of service for carriers. Although to the facility they represent profit, for inmate service providers they are a condition of doing business and are paid out of revenue, as is any

other cost. Were the Commission to impose, directly or indirectly, rate caps that do not include site commissions as a cost, it would most likely force carriers to provide service below cost. Such action would not only be unlawful, it would drive carriers from the market, eliminating the one basis for competition that remains in inmate telephone services.

Finally, the Commission should not view debit cards and prepaid systems as the panacea for increasing inmate telephone rates. Their presence in some facilities does not denote their success in lowering rates. In fact, they impose considerable additional costs that offset any purported savings they may bring in the form of lowering bad debt. Most importantly, debit cards do not in themselves remove site commissions, and thus do not address the core cause of inflated rates. Although encouraging them as an option for correctional facilities would be an appropriate course of action, the Commission should not consider debit cards to the exclusion of other relief, and should be aware of the special security concerns that they entail.

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20054**

In the Matter of)	
)	
Implementation of the Pay Telephone)	CC Docket No. 96-128
Reclassification and Compensation Provisions)	
Of the Telecommunications Act of 1996)	

REPLY COMMENTS OF T-NETIX, INC.

T-NETIX, Inc. ("T-NETIX"), by its attorneys, hereby replies to comments filed in response to the *Inmate Rate NPRM*¹ under consideration in this docket. T-NETIX disagrees with the suggestion that the Commission is not empowered to address inmate rates and site commissions on a nationwide basis under Section 276, much less that there is no need for the Commission to address these issues in the first instance. Nor should the Commission revisit the issue of mandating federal minimum rates for inmate telecommunications services, as it has rejected this proposal twice as not in the public interest. T-NETIX urges the Commission to focus on site commissions, which as T-NETIX and its expert economist Richard Cabe have explained,² place an increasing cost burden on carriers.

I. THE COMMISSION SHOULD EXERCISE ITS PLENARY SECTION 276 JURISDICTION TO ALLEVIATE THE UPWARD PRESSURE ON INMATE PHONE RATES CAUSED BY SITE COMMISSIONS

Most commenters agree that the Commission has the authority to take preemptive action with respect to the rates for inmate service as a federal matter.³ Congress's mandate in Section

¹ *Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-128, Order on Remand and Notice of Proposed Rulemaking, FCC 02-39 (rel. Feb. 21, 2002) ("Order on Remand" and "Inmate Rate NPRM," respectively).

² Declaration of Richard Cabe, Ph.D. (May 22, 2002) ("Cabe Decl."); Further Declaration of Richard Cabe, Ph.D. (June 21, 2002) ("Cabe Further Decl.") (attached hereto as Appendix A).

³ T-NETIX Initial Comments at 5-8; Comments of Citizens United for the Rehabilitation of Errants ("CURE Comments") at 4; Comments of the Inmate Calling Services Providers Coalition ("ICSPC Comments") at 2-3.

276 that the Commission “ensure that all payphone service providers are fairly compensated” delegates plenary authority over all payphones to the FCC.⁴ The Commission, having relied successfully on its Section 276 authority to deregulate local payphone coin rates,⁵ can and should invoke this authority in this instance in order to ensure not only that inmate services providers are fairly compensated, but also to address what it has been correctly termed “the upward spiral of increasing location rents and increasing inmate calling rates.”⁶ There can be no question that, as a matter of law, the Commission has the power to take nationwide action with respect either to inmate rates, site commissions, or both.

The Commission’s wide-reaching Section 276 authority is quite a different question, however, from the concerns raised by some parties regarding the role of state authorities in regulating inmate service rates.⁷ Specifically, the RBOC Payphone Coalition and WorldCom are concerned that Commission action with respect to inmate telephone rates may conflict with states’ authority to operate and maintain prisons. T-NETIX of course does not disagree that state agencies are typically endowed by statute with the power to obtain telecommunications services for inmates and to limit those services as necessary.⁸

Commission action on inmate rates can hardly be said to undermine the authority of state correctional agencies. It is uncontested that “the States have legitimate authority to limit inmates’ access to telephone service,” and that the creation single provider, collect call-only in-

⁴ 47 U.S.C. § 276(b)(1)(A).

⁵ *Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-128, Order on Reconsideration, 11 FCC Rcd. 21233, 21269 (1996), *aff’d in part and remanded in part*, *Illinois Pub. Tel. Ass’n v. FCC*, 117 F.3d 555 (D.C. Cir. 1997), *cert. denied sub nom. Virginia State Corp. Comm’n v. FCC*, 523 U.S. 1046 (1998).

⁶ *Inmate Rate NPRM* ¶ 73.

⁷ RBOC Payphone Coalition Comments at 4-5; WorldCom Comments at 6-7.

⁸ T-NETIX Initial Comments at 2-4.

mate phone system is “the legitimate exercise of the police power of the State.”⁹ Further, no party has suggested here that inmates have the “right to unlimited telephone use” or the right to the service provider of their choice.¹⁰ Nor has anyone alleged that state correctional authorities have violated any antitrust laws in imposing site commissions on providers of inmate services.¹¹ State agency control over the structure, scope and terms of telecommunications provided to inmates will remain unaffected by any Commission decision in this docket.

Site commissions generated by inmate calls are a different matter. State use of site commission revenues to defray the cost of prison administration, as opposed to general tax increases, is often a prudent policy.¹² Where, however, state correctional authorities have used their authority to extract payments from service providers in such a way as to force rates into an “upward spiral,”¹³ T-NETIX believes that due respect for state policies does not demand that the Commission refrain from exercising its responsibility to ensure that inmate telecommunications are provided at reasonable rates, terms, and conditions.¹⁴

Because each facility “exercises exclusive control over access to the inmate calling market,”¹⁵ site commissions are an unavoidable cost of doing business for inmate services providers.¹⁶ In addition, site commissions can rise, and in many cases have risen, to levels that put upward pressure on inmate phone rates.¹⁷ In some states, carriers pay as much as 55 percent of

⁹ RBOC Payphone Coalition Comments at 5. *See also Inmate Rate NPRM* ¶ 72; T-NETIX Initial Comments at 2-4.

¹⁰ RBOC Payphone Coalition Comments at 5 (quoting *Benzel v. Grammer*, 869 F.2d 1105, 1108 (8th Cir. 1989)).

¹¹ *See* RBOC Payphone Coalition Comments at 5.

¹² T-NETIX Initial Comments at 3; WorldCom Comments at 4-7.

¹³ *Inmate Rate NPRM* ¶ 73.

¹⁴ *See* 47 U.S.C. § 201(b).

¹⁵ *Inmate Rate NPRM* ¶ 73. *See also* CURE Comments at 3-4.

¹⁶ T-NETIX Comments at 3.

¹⁷ Cabe Decl. ¶ 2, 6; Cabe Further Decl. ¶ 10 & n.3.

revenue in site commissions.¹⁸ Thus, although the contract bidding system under which inmate providers are selected is vigorously competitive, the exclusive control exerted by each correctional facility, coupled with its statutory authority to enter into vendor contracts that require site commissions, results in inflated rates that principally benefit the facility.²⁰ This “misdirected competition” therefore has direct, negative effects on the rates for inmate phone service, which are within the Commission’s authority to mitigate.

It is difficult, if not impossible, to make a responsible objection to the use of site commissions as a means of paying for prison administration rather than burdening the general tax fund. There is a logical connection between the source and the recipient of the commission payment, especially in the case where the funds go toward maintaining security of the telephone facility. The growing trend in the correctional system, however, is that site commission revenues are absorbed into the general state fund for appropriation by the Legislature.²¹ This use of site commissions does not benefit the inmates or the facilities, but rather converts the inmate phone system into one more tax base for the state. As a result, the recipients of inmate calls are paying higher rates not for the benefit of the inmate, or to fund the operation of correctional institutions in lieu of ordinary taxpayers, but rather to provide for wholly unrelated state programs. It is therefore questionable whether as a matter of law or policy these types of site commission mechanisms are a valid exercise of the states’ police power having a rational relation to penological purposes.

The Commission therefore should have few reservations about the prudence of invoking

¹⁸ Attached hereto as Appendix B is a Site Commission Survey providing information that T-NETIX has found regarding existing levels of site commission percentages and revenues.

²⁰ *Id.* ¶ 6.

²¹ T-NETIX Initial Comments at 3 n.9. *See also Inmate Rate NPRM* ¶ 73 (“Commission proceeds may be dedicated to a fund for inmate services or assigned to the state’s general revenue fund.”).

Section 276 to prohibit or substantially curtail, as a federal matter, the imposition of site commissions on inmate services providers. As further addressed in Dr. Cabe's declaration, this action is the best regulatory course. It is the only step that will directly address the problem of excessive inmate service rates, because, as the Commission recognizes, commissions are the "single largest component affecting the rates for inmate calling service."²² State regulatory agencies have to this point largely been unable to relieve service providers of this cost burden,²³ hence the Commission's help is needed. By abolishing or limiting site commissions, the FCC will ensure that this market is subject to competition not on the basis of site commissions, but rather on technological innovation, end user rates and quality of service. Such action will thus "redirect[] competition to the benefit of those who pay for inmate calling."²⁴

WorldCom's comments suggest, incorrectly, that site commissions for inmate services have no relation to the increase in inmate collect calling rates.²⁵ This position is not defensible. First, as the data compiled in Appendix B indicates, the states with the highest inmate rates have also seen the greatest increases in site commission levels. Second, WorldCom's argument that carriers will not *raise* rates to support higher commission payments rests on the assumption that every providers' rates are *already* at the maximum allowed, which is not necessarily correct. Further, WorldCom does not address the positive incentive for carriers to increase rates to whatever maximum level is permissible in order to maximize their commission payments and, thus,

²² *Order on Remand* ¶ 10. In case of the T-NETIX, Dr. Cabe's cost analysis demonstrated that site commissions are the largest cost component in T-NETIX's rates. Cabe Decl. ¶ 5.

²³ See Cabe Decl. ¶ 5 ("[T]he amount of location rents currently received by facilities indicates the inability of states to ensure that the benefits of competition accrue to the end user inmates and their families."). T-NETIX notes, however, that the New Mexico Public Regulation Commission will soon consider a Proposed Order in the rate investigation it conducted last year into inmate service rates; that Proposed Order requires, based on New Mexico's new statutory prohibition on revenue-based site commissions, all inmate service providers to remove site commissions from their rates for all new contracts. See Cabe Decl. ¶ 13. This potential regulation is over 2 years in the making and required the affirmative action of both the Legislature and the Commission to complete — one cannot expect swift or uniform results from this unwieldy process.

²⁴ Cabe Decl. ¶ 11.

²⁵ WorldCom Comments at 7.

the number of institutions they can serve. Perhaps more importantly, the dynamics of how inmates rates came to be as high as they currently are is not really the issue. The important fact is that inmate rates could be much lower, and that competition would be redirected from commissions to innovation and cost-efficiency if carriers were prohibited from or limited in making site commission payments.

T-NETIX emphasizes that in supporting restrictions on site commissions, it is not proposing that the FCC dictate to states how to fund their correctional institutions or what limitations to place on inmates' telecommunications privileges. These are matters clearly committed to state legislatures and agencies. Nor are we suggesting that all states or all institutions have succumbed to the temptation to maximize commission revenues or to divert them to non-correctional purposes. T-NETIX does believe, however, that the preoccupation with site commissions has sheltered some carriers from the rigors of competition by reducing incentives for innovation, R&D, and efficiency. Because it rewards competitors with deep pockets who are better able to shift the cost burden of site commissions to other products and services, the existing system of inmate rates benefits carriers whose interests are not aligned with consumers. T-NETIX is convinced that, by reducing or eliminating the distortions caused by competition for commissions, the FCC could restore competition directed to prices, costs and end user quality to the inmate market.

II. THE COMMISSION SHOULD NOT REVISIT ITS DECISION TO REJECT A FEDERAL PER-MINUTE MINIMUM RATE

The Commission should not entertain ICSPC's request for a \$2.44 federal minimum rate for inmate calls.²⁶ That request is simply another attempt by ICSPC to obtain reconsideration on the issue of a per-call surcharge for inmate services, in addition to the "Further Reconsideration"

²⁶ ICSPC Comments at 3-5, 6-7.

it has already filed,²⁷ which is barred as a matter of Commission procedure. Moreover, ICSPC's request is the diametric opposite of the Commission's goal in this proceeding of exploring ways of lowering, not raising, inmate phone rates.

ICSPC already has requested — twice — a per-call surcharge on all inmate calls “because inmate providers have higher service costs than other PSPs.”²⁸ The Commission soundly denied that request, and then denied ICSPC's subsequent petition for reconsideration, holding unequivocally in the companion *Order on Remand* that “ICSPC's members have not demonstrated that they are entitled to further compensation.”²⁹ ICSPC has already sought “further reconsideration” of that holding,³⁰ and now here performs essentially the same task; its “comments” are little more than a “second further reconsideration.” This third bite at the apple is improper procedurally and unsubstantiated factually. It should therefore be denied summarily.

The Commission will dismiss any petition for reconsideration that is not timely filed³¹ or that fails to raise any new fact not previously in the record.³² ICSPC's comments suffer from both infirmities. First, they cover exactly the same ground as ICSPC's petitions for reconsideration.

²⁷ CC Docket No. 96-128, Petition for Further Reconsideration of the Inmate Calling Services Providers Coalition (filed Mar. 25, 2002).

²⁸ ICSPC Comments at 2 (Oct. 21, 1996).

²⁹ *Inmate Rate NPRM* ¶ 24.

³⁰ ICSPC technically seeks reconsideration of the standard applied by the Commission when it determined that inmate PSPs are fairly compensated. ICSPC Petition for Further Reconsideration at 14-16. At bottom, this argument is an effort by ICSPC to get Commission approval for higher rates and is functionally the same request as was made in its first petition for reconsideration.

³¹ Section 405 of the Communications Act of 1934 grants parties the right to seek reconsideration of a Commission order within 30 days. 47 U.S.C. § 405. The Commission “has consistently held that it is without authority to extend or waive the statutory” deadline. *In re Mobile Relay Associates*, File No. A023000, Order on Reconsideration, DA 00-0751 (rel. Apr. 6, 2000) (rejecting petitioner's late request for reconsideration of technical requirements for a mobile relay services). In fact, federal appellate courts have overruled Commission amendment of rules on reconsideration where the underlying petition was filed after the 30-day window. *E.g.*, *Reuters Limited v. FCC*, 781 F.2d 946, 952 (D.C. Cir. 1986).

³² *E.g.*, *Applications of Washington Broadcast Company for Renewal of Licenses of Stations WJPA (AM)/WJPA (FM), Washington, Pennsylvania*, File Nos. BR-910401YL *et al.*, Memorandum Opinion and Order, FCC 99-252 (rel. Sept. 23, 1999) (“Reconsideration will not be granted for the purpose of debating matters on which we have already deliberated and spoken.”); *Implementation of Section 309(j) of the Communications Act—Competitive Bidding for Commercial Broadcast and Instructional Fixed Service Licenses*, MM Docket No. 97-234, Memorandum Opinion and Order, DA 00-445 (rel. Mar. 1, 2000).

tion. They are almost entirely devoted to justifying a federally mandated \$2.44 flat rate for inmate calls,³³ based on the *identical justifications* offered to support the \$0.90 per-call surcharge that ICSPC already requested and lost. According to call revenue data provided by ICSPC in a 1999 ex parte, the average per-call revenue of inmate PSPs is \$1.60;³⁴ \$1.60 plus a \$0.90 federal surcharge equals a rate of \$2.50 per call. The instant request for a \$2.44 per-call federal rate is just a slight amendment.³⁵

Second, ICSPC's comments are simply a vehicle for submitting purportedly "new" cost data into the record that it neglected to attach to its further reconsideration. Relying on the Commission's "invitation" for cost information, ICSPC appends a "Local Call Cost Study" to its comments that was not provided with its March 25 petition. In so doing, ICSPC seems to be setting up its comments as a third (or perhaps fourth) attempt at finally obtaining a guaranteed federal call rate in the event that its petition is denied.

Regardless of the procedural defects in ICSPC's comments, its request for a \$2.44 federal per-call rate is unhelpful and without substantive merit. Rather than provide the Commission with insight into ways that it might act to relieve the cost burdens of inmate service providers, ICSPC simply summarizes the existing cost structure and requests that the Commission guarantee cost recovery for it. Section 276 provides that payphone operators are entitled to "fair compensation" for calls, not to a cost-plus or rate-of-return model for guaranteeing carriers a profit in excess of that which they have freely negotiated with their correctional institution customers. Moreover, the Local Call Cost Study included with ICSPC's comments focuses largely on uni-

³³ ICSPC Comments at 2-7.

³⁴ ICSPC provided data for carriers in Alabama, Arizona, Iowa, Louisiana, and Maryland. CC Docket No. 96-128, Notice of Ex Parte Presentation at 2 (Oct. 14, 1999).

³⁵ The Local Call Cost Study appended to ICSPC's comments indicates that the "weighted average" of costs per line at certain "marginal locations" is \$2.44. It is nonetheless striking how closely this figure hovers to ICSPC's earlier request.

identified “marginal locations” (locations for which no site commissions are paid) yet seeks a ubiquitous \$2.44 national rate;³⁶ few facilities are, however, “marginal locations,” which raises the possibility that adoption of this rate on a national basis will result in over-recovery in the overwhelming majority of prisons for which site commissions are paid. Thus, although the Commission did seek comment on the costs that carriers incur in serving correctional facilities, ICSPC’s cost study does little, if anything, to substantiate its claim that its members are somehow forced to provide inmate services at below-cost or somehow “unfair” rates.³⁷

Finally, ICSPC’s comments rest on a theory that is internally inconsistent. ICSPC states that “a government-mandated rate” has operated in the inmate services market and “has kept the market from functioning to ensure fair compensation.”³⁸ It also maintains that, in both the public payphone and prison payphone contexts, “a ‘government-mandated rate’ was a barrier to fair compensation.”³⁹ ICSPC nonetheless requests a ‘government-mandated rate’ of \$2.44 in the next paragraph. T-NETIX finds it extremely difficult to reconcile these positions, and suggests that if ICSPC seeks to remove government from ratesetting, a rate set by the FCC is no more beneficial than the state commission rates that ICSPC apparently dislikes.

The Commission should therefore not adopt ICSPC’s proposal, which would only ratchet inmate rates upward. Rather, it should focus on the cost causers that the NPRM correctly identified, principally site commissions, and use its federal authority in that direction. In this way, the Commission will truly ensure that inmate rates more closely resemble public payphone rates rather than a protected, locational monopoly rate regime.

³⁶ Local Call Cost Study, Section B.

³⁷ The study also includes a good deal of legal analysis of the proper ratesetting methodology for payphone rates and the definition of “fair compensation” as required in Section 276. Local Call Cost Study, Section C.

³⁸ ICSPC Comments at 5-6.

³⁹ *Id.* at 6.

III. THE COMMISSION SHOULD NOT SET OR REQUIRE RATE CAPS THAT DO NOT PERMIT THE RECOVERY OF SITE COMMISSION COSTS

As T-NETIX has explained, rate caps are an imprecise, unwieldy tool for regulating inmate telephone rates.⁴⁰ Although it is true, as CURE indicates, that several states have imposed rate caps “after finding that the rates being charged could not be justified,”⁴¹ rate caps do not address the underlying cause of such unjustified rates: excessive site commissions. Moreover, rate caps are often set at levels already far above cost, generally being merely a codification of the high rates charged by the incumbent LEC other “dominant” carrier.⁴² Finally, the Commission’s experience with the per-call compensation proceedings for general payphones – on which its rate determinations have been repeatedly reversed on appeal – clearly demonstrates the difficulty in crafting a ratemaking methodology without resorting to ineffective, and perhaps unlawful, rate-of-return methodologies.⁴³ A rate cap will not address the problem of high site commissions, and unless that issue is addressed directly, there will be no reason to consider a rate cap. For these reasons, T-NETIX continues to urge the Commission to avoid setting rate caps in favor of direct action to limit or abolish site commissions.

Should the Commission nonetheless conclude that rate caps may be one tool for preventing rate inflation, it should do so with a clear understanding of the true costs faced by inmate service providers. Specifically, it must recognize that site commissions are a cost to carriers, and not a source of profit. As Dr. Cabe analysis demonstrates conclusively, “[s]ite commissions must be regarded both as a location rent to confinement facilities and as a cost to ICS providers.”⁴⁴

⁴⁰ T-NETIX Initial Comments at 10-12; Cabe Decl. ¶¶ 9-10.

⁴¹ CURE Comments at 5-6.

⁴² T-NETIX Initial Comments at 11; Cabe Decl. ¶¶ 5-6.

⁴³ *Illinois*, 117 F.3d at 570; *MCI v. FCC*, 143 F.3d 606 (D.C. Cir. 1998).

⁴⁴ Cabe Further Decl. ¶ 7.

It is simply untrue that “location rents are not a cost of payphones, but should be treated as a profit.”⁴⁵ Though they may be a profit to the correctional facility, or to the state general fund, site commissions are in fact payments that carriers must make to facilities out of the revenues they receive from inmate calls.⁴⁶ They are a condition of participation in any state or local competitive bid, and are included in some form in every inmate telephone service contract.⁴⁷ Were the Commission to establish a rate cap, or to instruct state commissions to set rate caps, based upon the premise that site commissions may not be deemed a cost of service, it would “prevent providers from recovering all costs.”⁴⁸ Setting rates that preclude full recovery of all costs legitimately incurred contravenes well-settled principles of ratesetting methodology.⁴⁹ As the New Mexico commission recently concluded, site commission are “prudently incurred” costs whose recovery cannot be foreclosed, so long as carriers remain liable to pay them to correctional institutions, without violation prohibitions on retroactive ratemaking and impairment of private contracts.⁵⁰

T-NETIX therefore urges the Commission not to rely on its earlier determination that site commissions are profit — which was appropriate in the context in which it was reached — in the event it finds that rate caps are necessary for regulating inmate service rates.⁵¹ Relying on this premise would punish carriers in this market by ignoring the market realities that they face in

⁴⁵ *Inmate Rate NPRM* ¶ 15.

⁴⁶ Cabe Decl. ¶ 5; Cabe Further Decl. ¶ 5.

⁴⁷ *See Order on Remand* ¶ 10; T-NETIX Initial Comments at 3.

⁴⁸ Cabe Further Decl. ¶ 6.

⁴⁹ *FPC v. Hope Natural Gas*, 320 U.S. 591 (1994).

⁵⁰ *Investigation Into the Rates and Practices of Institutional Operator Service Providers*, Case No. 3317, Recommended Decision of the Hearing Examiner 21 (citing *Rubalcava v. Garst*, 53 N.M. 295, 206 P.2d 1154 (1949)), and 22-23 (quoting *Application of General Tel. Co.*, 98 N.M. 749, 52 P.2d 1200 (1982)).

⁵¹ The Commission held in 1999 that, with regard to whether a payphone site receives fair compensation, the location rent associated with placement of the payphone would be treated as a profit. CC Docket No. 96-128, Third Report and Order and Order on Reconsideration of the Second Report and Order, 14 FCC Rcd. 2545, 2615-16 (1999). There, the Commission reasoned that the location rent “provides increased value to the premises.” *Id.* This holding does not speak to the case at hand, in which service providers must pay a percentage of gross revenue to a third party, thus diminishing their return on investment. In that context, these payments clearly constitute a cost of service. *See generally* Cabe Decl. ¶ 8.

serving inmates. Unless it concurrently adopts T-NETIX's proposal to abolish site commissions, the Commission must recognize that commissions are a drain on carrier revenue for which they must be compensated. To do otherwise could force carriers from this market altogether, as they would be unable to realize any reasonable return on investment. "Because site commissions comprise such a large share of providers' costs of providing service under existing contracts, no provider denied the opportunity to recover the cost of site commissions could continue to operate under existing contracts."⁵² This is plainly not a result that the Commission desires to achieve, or should achieve, with its Section 276 policies.

IV. THE RECORD DOES NOT SUPPORT THE ADOPTION OF DEBIT CARDS FOR INMATE TELEPHONE SERVICES

Debit cards and other forms of prepaid inmate telephone services will not resolve the Commission's concerns regarding inmate telephone rates. Though they may offer inmates a choice of methods by which to purchase services,⁵³ debit card systems do little to eradicate the "extraordinary" circumstances,⁵⁴ and thus the special costs, that inmate service entails. The fact that they are in place in the federal system and in some states demonstrates only that debit cards are technically feasible in some settings, but is not indicative of their ability to lower inmate rates.

As Dr. Cabe explained, debit card systems merely "offer some promise of reducing costs of inmate calling."⁵⁵ First, their ability to lower bad debt is not certain, because if they are purchased only by customers that would otherwise consistently pay their bills on time, while other, less reliable end users retain the typical billing option, there will be no alleviation of the costs of

⁵² Cabe Further Decl. ¶ 10.

⁵³ See CURE Comments at 7.

⁵⁴ *Policies and Rules Concerning Operator Service Providers*, CC Docket No. 90-313, Report and Order, 6 FCC Rcd. 2744, 2752 (1991).

⁵⁵ Cabe Decl. ¶ 7.

collection and unpaid bills.⁵⁶ Dr. Cabe terms this phenomenon “adverse selection.” Secondly, even if they successfully lower bad debt, they have their own attendant costs of implementation and administration, which will offset any savings accrued.⁵⁷ Finally, and most importantly, implementing debit card or prepaid systems will not have any affect whatever on the costs of site commissions; facilities may, in fact, actually increase their site commissions to capture any cost savings that would otherwise accrue from debit card implementation. Prisons can obtain site commissions just as easily from prepaid revenue as from billed revenue.

More importantly, debit cards entail security risks that cannot be ignored.⁵⁸ They are fungible assets that can be extorted by force.⁵⁹ In addition, they introduce one more item into the prison setting that can be made into a weapon.⁶⁰ The Commission should be mindful of these risks and balance them against the purported cost savings that they provide. The FCC has always been especially mindful of the unique security concerns facing correctional institutions.⁶¹ To mandate a debit card system, in T-NETIX’s view, would far more directly interfere with the legitimate authority of state correctional authorities than would any restriction on site commissions or other direct regulation of inmate service rates.

CONCLUSION

For all these reasons, the Commission should focus on site commissions in addressing its concerns regarding rates for inmate telecommunications services and should exercise its plenary

⁵⁶ See Cabe Decl. ¶ 7.

⁵⁷ See *id.* See also WorldCom Comments at 11 (“ICS providers and state administrators would not save 30% if state prison authorities were to adopt debit account billing.”).

⁵⁸ See CURE Comments at 7-8.


⁵⁹ Testimony of Michael R. Horcasitas, Qwest Corp., at 4-5 (N.M.P.R.C. Aug. 31, 2001), attached to T-NETIX’s Initial Comment at Appendix E.

⁶⁰ *Id.*

⁶¹ *E.g., Billed Party Preference for InterLATA 0+ Calls*, CC Docket No. 92-77, Second Further Notice of Proposed Rulemaking, 11 FCC Rcd. 7274, 7301 (1996) (noting that “prisons often install and maintain security equipment for a number of legitimate reasons involving security and other government prerogatives”).

Section 276 authority to establish direct, nationwide rules for site commissions payable on inmate services.

Respectfully submitted,

By: 
Glenn B. Manshin
Stephanie A. Joyce
Kelley Drye & Warren LLP
1200 19th Street, N.W., Suite 500
Washington, D.C. 20036
202.955.9600
202.955.9792 fax

Counsel to T-NETIX, Inc.

Dated: June 24, 2002

APPENDIX A

Further Declaration of Richard Cabe, Ph.D.

June 21, 2002

**Before the
Federal Communications Commission
Washington, D.C. 20554**

In the Matter of)	
)	
Implementation of the Pay Telephone)	CC Docket No. 96-128
Reclassification and Compensation Provisions)	
Of the Telecommunications Act of 1996)	

FURTHER DECLARATION OF RICHARD CABE, Ph.D.

1. My Name is Richard Cabe. My background was discussed in my declaration attached to the Initial Comments of T-NETIX, Inc., filed in this Docket on 24 May, 2002.
2. The purpose of my declaration is to discuss the economic character of site commissions in economic analysis of costs, if the analysis is to be used to develop a rate cap for Inmate Calling Services (ICS). While incremental cost at a marginal location may be the appropriate method to establish MINIMUM fair compensation, this approach is inappropriate for the purpose of establishing a rate cap, which is a MAXIMUM charge.
3. The *Order and NPRM* now under consideration seeks to “explore whether the current regulatory regime applicable to the provision of inmate calling services is responsive to the needs of correctional facilities, ICS providers, and inmates, and, if not, whether and how we might address those unmet needs.”¹ The Commission also notes its earlier finding that “location rents are not a cost of payphones, but should be treated as profit.”² If the Commission were to consider a rate cap plan, which I believe is not necessary, this finding would be an inappropriate starting point for the Commission.

¹ *Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-128, Order on Remand and Notice of Proposed Rulemaking, FCC 02-39 at ¶ 72 (released February 21, 2002) (*Order and NPRM*).

² *Order and NPRM* at ¶ 15 citing *Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-128, Third Report and Order, and Order on Reconsideration of the Second Report and Order, 14 FCC Rcd 2545 (1999) (*Third Report and Order*).

4. In establishing a per call compensation plan, the Commission essentially established a minimum contribution to common costs.³ The Commission has explicitly rejected a request to establish a plan based on uniform contributions from all calls.⁴ A rate cap, however, determines the highest rates that can be charged, and thus establishes maximum contributions.
5. Site commissions must be considered a cost of providing ICS if the Commission is going to set, or instruct the states to set, an ICS rate cap. In the context of ICS, as the Commission recognizes, “[t]o have a realistic chance of winning a contract, the bidder must include an amount to cover commissions paid to the inmate facility.”⁵ When a contract between an ICS provider and a confinement facility is signed, those commissions become costs to the ICS provider. Any rate cap plan that failed to recognize these costs would deny the provider an opportunity to recover legitimate costs that were essential to the ICS provider’s winning the contract. Without committing to pay commissions the provider had no “realistic chance of winning a contract,” and when the contract takes effect the ICS provider is obligated to pay commissions as a condition of providing service to inmates at that facility.
6. The Commission has previously determined that a provider is fairly compensated if revenue from a call covers the marginal cost of that call and makes some contribution to fixed and common costs. The Commission recognized as recently as the *Order and NPRM*, however, that the fairness of such a compensation plan would come into question if the plan were to prevent providers from recovering all costs, after considering revenue from all calls.⁶ Thus, while analysis of cost based on the concept of marginal or incremental cost is appropriate to

³ *Order and NPRM* at ¶ 18 and 19, quoting *Third Report and Order*, 14 FCC Rcd. at 2570.

⁴ *Id.* at ¶ 20.

⁵ *Order and NPRM* at ¶ 10.

⁶ *Id.* at ¶ 23, condition ii.

determine whether a particular call makes a contribution to common costs, it is not appropriate for determining the level of a rate cap.

7. Site commissions must be regarded both as a location rent to confinement facilities and as a cost to ICS providers.⁷ For the purpose of identifying marginal locations for payphones available to the general public,⁸ site commissions are a form of location rent — income to the correctional facility. For the purpose of developing a rate cap plan, which must allow regulated firms an opportunity to recover the necessary costs of providing service, site commissions required by existing contracts must be regarded as a cost to the ICS provider.
8. The fact that site commissions reflect the market power of a confinement facility is not pertinent to the fact that site commission payments are a necessary cost of doing business as an ICS provider. Nor was the market power of location providers the determining factor in the Commission's finding that location rents should not be regarded as costs for the purpose of establishing per call compensation in the case of payphones available to the general public. For that determination the Commission relied on the fact that a marginal payphone location pays no location rent, but "that a marginal payphone location is a viable payphone location, because the payphone provides increased value to the premises."⁹ The Commission's attention in that determination was rightly directed to marginal payphone locations "to ensure that the current number of payphones is maintained,"¹⁰ in a setting where the number of payphones is determined by market considerations. In the ICS context,

⁷ Technically, if there were some level of site commission that a facility must receive in order to make space available to an ICS provider, the 'rent' component of the site commission would be the portion of the site commission in excess of the minimum level necessary to induce the facility to allow inmate access to telecommunications services. The usual analysis for such a question — the market value of the pertinent resource in its next most valuable use — is inapplicable for the reason noted by the Commission in the *Order and NPRM* at ¶ 19: "the correctional facility and its communications policy, not the market, often determine the number of prison phones."

⁸ Again, the usual economic analysis required to reach this question is inapplicable in the ICS context. *See id.*

⁹ *Third Report and Order* at ¶ 156.

¹⁰ *Order and NPRM* at ¶19 quoting *Third Report and Order*.

however, attention to market behavior in marginal payphone locations is not justified because “the correctional facility and its communications policy, not the market, often determine the number of prison payphones.”¹¹

9. In the case of a rate cap plan that did not consider all necessary costs of doing business – whether marginal costs or fixed and common costs – a failure “to recover its total costs from its aggregate revenues”¹² would be built into the plan. As the Commission acknowledged in the *Order and NPRM* at ¶10, existing contracts would not have been awarded without specification of site commissions. Adoption of a rate cap plan that fails to recognize contractual obligations to pay site commissions would clearly deny providers committed to existing contracts an opportunity to recover the necessary costs of doing business in providing telecommunications services to inmates.
10. If government policy were to reduce rates below the level necessary to recover the substantial cost of site commissions required by existing contracts, providers would certainly fail to recover total costs from aggregate revenues. Because site commissions comprise such a large share of providers’ costs of providing service under existing contracts, no provider denied the opportunity to recover the cost of site commissions could continue to operate under existing contracts. It is difficult to imagine a more disruptive government intervention than one that results in overturning existing contractual relations on such a large scale. The very magnitude of site commissions makes this component of ICS providers’ cost structures simultaneously the most promising avenue for reducing rates for telecommunications services to inmates,¹³ and also a crucial component of the web of contractual relations that

¹¹ *Order and NPRM* at ¶ 19.

¹² *Id.*

¹³ WorldCom, Inc. Comments (at page 7) argue that “Commission Fees Are Not Responsible For An Upward Spiral In Collect Call Fees and Rates.” This argument that providers will not raise rates to support higher commission

comprise the industry, as presently structured. Disturbing this component of existing contracts would create great uncertainty that could very possibly harm competition and diminish the present quality and efficiency of service to inmates.

11. This concludes my Further Declaration.

payments rests on the presumption that the provider's rates are already at the maximum allowed, and does not address the incentive created for providers with rates currently below the maximum allowed. Further, the dynamics of how rates came to be as high as they are is not really the issue. The important fact is that rates could be much lower if they did not have to support site commission payments.

I declare under penalty of perjury that the foregoing is true and correct.

Executed on 21 June, 2002.

Richard Cabe

Richard Cabe

APPENDIX B

T-NETIX Site Commission Survey

California		23.2	1998		Holland (MI) Sentinel, 8/25/99
California	44/33	16.0 / 20.0**	1998 / 2000**	MCI, GTE/Verizon	SF Chronicle, "A Cruel and Unusual Prison Phone Scam," 6/15/1999
California	43	30.0	2001	MCI, Verizon	LA Weekly, 6/21/01
FED Bureau of Prisons		26.0	12/7/2000	DynCorp IS; US Sprint for LD	CA Study (cited in VA Report); FCC NPRM
Florida		14.7	1998		Holland (MI) Sentinel, 8/25/99
Florida	57/50	14.7	1998	Sprint, MCI	AP/Naples Daily News, 9/1/99
Florida		16.0	2000		The Augusta (GA) Chronicle, 9/2/01
Georgia	46/37	10-12	1999	Bell South, Sprint	Washington Post, January 23 2000
Georgia		10.0	2000		The Augusta (GA) Chronicle, 9/2/01
Georgia		12.0	2001	WorldCom	Savannah Morning News, 1/18/02
Idaho	41	1.1	2000	AT&T (subs to Qwest & Verizon)	Report of Office of Performance Evaluations of the Idaho State Legislature, January 2001
Illinois	50	12.2	1998	MCI WorldCom, AT&T, Consolidated Communications	Holland (MI) Sentinel, 8/25/99
Illinois	50	12-16	1999	Consolidated, AT&T, Ameritech	Washington Post, January 23 2000
Indiana	53	11.0	2000	AT&T	Indianapolis Star, November 12 2001
Indiana	45	6.0@	2001	T-NETIX	Indianapolis Star, November 12 2001
LA County	42	23.3***	2001-2003***	Pacific Bell	LA Weekly, 6/21/01+G37
Maryland	42/20&	6.6	2000	AT&T, Bell Atlantic/Verizon	Maryland Justice Policy Institute (http://www.md-justice-policy-inst.org/TelPro.htm)
Michigan	34, 30, 18	10.3	1999	Sprint, Ameritech, GTE (local calls)	Washington Post, January 23 2000
Missouri		14.0	1999		Village Voice, 7/12-7/18/2000
Missouri	55/25	9-11	1999	MCI, Eagle Com., Southwest Bell	Washington Post, January 23 2000
Nebraska	0	0.0	2001		The Augusta (GA) Chronicle, 9/2/01

Nevada	50		2000		Report of Office of Performance Evaluations of the Idaho State Legislature, January 2001
New Mexico	33		1997-2001	T-NETIX	Cabe's declaration
New York	60#	21.0	1999	MCI	Village Voice, 7/12-7/18/2000
New York	60	20.5	1999	MCI, Bell Atlantic	Washington Post, January 23 2000
North Carolina	46	7.0	FY97-98	Taltons	"Maintaining Family Contact When a Family Member Goes to Prison", prepared by Florida House of Rep. Justice Council, Nov. 1998
Ohio	35	14.1	1999	MCI, Shawntech	Washington Post, January 23 2000
Ohio	50	13 / 16.4 / 18.4	1998/99/2000	WorldCom	Cincinnati CitiBeat, Aug 17-23, 2000
Oklahoma	45/35	1.9 (.7 profit)	2000	AT&T, Southwestern Bell	Cell Door Magazine, March 2001
Oregon	38^		2000		Report of Office of Performance Evaluations of the Idaho State Legislature, January 2001
Pennsylvania	50/30	3.0	1999	T-Netix, Bell Atlantic, AT&T, GTE	Washington Post, January 23 2000
South Carolina	48	5.0	2000	Sprint	The Augusta (GA) Chronicle, 9/2/01
Utah	38		2000		Report of Office of Performance Evaluations of the Idaho State Legislature, January 2001
Virginia			1996	MCI WorldCom, AT&T, Evercom, ASC Telecom, Pay Tel Commun.	Report of the SCC's Div. of Communications To VA Speaker of the House, 2000
Virginia	39	10.4	1999	MCI	Washington Post, 1/23/00
Virginia	40		1999		Washington Post, 1/23/00

*Unless specifically noted, figure assumed to be gross commission revenues

**2000 figure is projected

***Estimated revenue of \$70 MM over indicated three years. With roughly 22,000 inmates in the LA County system, that equates to \$1060 of commission revenue per inmate, per year.

^Commission rate was replaced in 1998 with a franchise fee resulting in comparable revenues

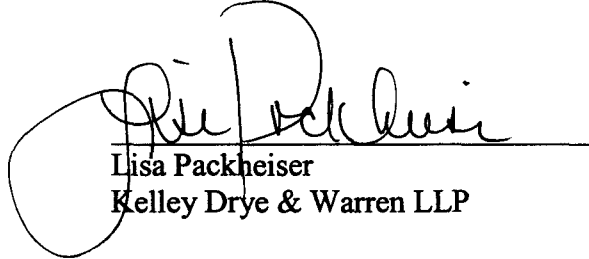
#In NY, 60% of the surcharge goes to the state; unclear whether state receives commission on per-minute rates

&Maryland takes 42% of long-distance revenues, and 20% of local & non-long-distance toll revenues

@Jay McQueen, deputy commissioner and general counsel of the Department of Administration, estimated 2001 revenues would reach this amount

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing Reply Comments were sent by First Class mail, postage prepaid to each of the persons listed below on June 24th, 2002.



Lisa Packheiser
Kelley Drye & Warren LLP

Robert E. Stup, Jr.
Christopher R. Bjornson
Mintz, Levin, Cohn, Ferris, Glovsky and Popeo, P.C.
701 Pennsylvania Ave., N.W.
Washington, D.C. 20004

Counsel for Citizens United for the Rehabilitation of Errants

Albert H. Kramer
Robert F. Aldrich
Dickstein Shapiro Morin & Oshinsky
2101 L Street, N.W.
Washington, D.C. 20037

Counsel for Inmate Calling Services Providers Coalition

Michael K. Kellogg
Aaron M. Panner
Teal E. Luthy
Kellogg, Huber, Hansen, Todd & Evans, P.L.L.C.
1615 M Street, N.W., Suite 400
Washington, D.C. 20036

Counsel for RBOC Payphone Coalition

Larry Fenster
WorldCom, Inc.
1133 19th Street, N.W.
Washington, D.C. 20036